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IN THE

# Supreme Court of the United States

October Term, 1956.

No. 99.

PACIFIC WESTERN OIL CORPORATION, a corporation, Successor in Interest to George F. Getty, Inc.,

*Appellant,*

*vs.*

FRANCHISE TAX BOARD, State of California,

*Appellee.*

## BRIEF IN OPPOSITION TO MOTION TO DISMISS.

Appellant, PACIFIC WESTERN OIL CORPORATION, pursuant to Rule 16 of the Revised Rules of the Supreme Court of the United States, herewith submits its Brief in Opposition to the Motion to Dismiss.

Since the Notice of Appeal was filed, on March 23, 1956 Appellant's name has been changed to Getty Oil Co.

### I.

### Introduction.

The Motion to Dismiss is predicated upon the assertion that this Court should accept without reexamination the findings of fact made by the trial court. Appellee thus seeks to avoid plenary consideration of the Constitutional issues here presented. Appellee does not claim that novel issues of taxation are lacking; or that the issues are not

of universal importance to the diversified national corporations of today; or that there is absent a need for guidance by this Court. Rather, its approach is that there exists no valid reason for reviewing the findings by reexamining the undisputed evidence.

Appellee recognizes that this Court is free to examine the entire record where constitutional rights and immunities are presented, and that findings of fact, when not supported by substantial evidence can be disregarded. (Motion p. 10.) This Court has said:

> "In all cases coming to us from a state court, we pay great deference to its determination of fact. But when the existence of an asserted Federal right or immunity depends upon the appraisal of undisputed facts of record, or where reference to the facts is necessary to the determination of the precise meaning of the federal right or immunity, as applied, we are free to reexamine the facts as well as the law in order to determine for ourselves whether the asserted right or immunity is to be sustained" (*Hooven & Allison Company v. Evatt,* 324 U. S. 652, at 659, 89 L. Ed. 1252, at 1260, 15 S. Ct. 870, at 874).

The Motion to Dismiss, therefore, raises squarely the question whether this Court should review the findings and reexamine the record. Because the concepts regarding commercial domicile and taxability of income from intangibles involve intermingled questions of fact and law, such a reexamination in the light of the Federal rights denied is warranted.

Appellee argues that if the findings be accepted, no federal question exists. The findings are very broad. They are the findings prepared by appellee and submitted

to the trial court, and endorsed by it without any changes whatsoever, in spite of objections and written argument by appellant. Of utmost importance is that appellee does not dispute the existence of a federal question if the record be examined.

In support of its argument that this Court should not examine the record appellee asserts that there were numerous conflicts in the evidence and, therefore, the findings are significant (Motion p. 6). The record is large and bulky, but this is because of the number and size of exhibits. It is essentially an uncontradicted record. All the testimony came from appellant's officers and counsel; all the documents came from appellant's files and records. The conflict results not from the testimony and evidence, but rather from the inferences and conclusions. We do not dispute the evidentiary facts appellee has set forth in its Motion (pp. 11-16). Nor does appellee dispute the evidentiary facts set forth in the Statement as to Jurisdiction (pp. 6-13). Furthermore, as the briefs in the courts below illustrate, there has been no disagreement concerning the facts themselves. The District Court of Appeal stated in its opinion in this case:

> "There is no substantial disagreement between the parties hereto as to the existence of the foregoing facts. The controversy centers around inferences which may be drawn from those facts." (Statement as to Jurisdiction, Appendix A, p. 10.)

The trial court found[1] from the evidentiary facts that:

1. The taxpayer's "commercial domicile" was in California.

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[1]The District Court of Appeal upheld the conclusions of the trial court but did not profess to weigh the undisputed facts.

2. That taxpayer did not have a commercial domicile in New Jersey.
3. The intangibles in question were related to and useful in taxpayer's California activities.

Appellant has sought review in this Court because the evidentiary facts do not give substantial support to those findings. The determination of commercial domicile depends upon an analysis of the relevant factors. What factors are relevant and what weight should be given to certain of them is in dispute here. No dispute exists, however, regarding the evidentiary facts themselves.

The issue here is a Constitutional one. The judgment below results in taxation measured by certain income. The facts disclose that such income was not subject to taxation because it is beyond the Constitutional limits of the taxing authority. The statute under which the tax was imposed is, therefore, unconstitutional as applied to this income. Rather than to accept without question the findings of the trial court which constitute a more or less perfunctory endorsement of findings prepared by appellee to fortify the trial court's decision, this Court should examine the facts themselves. Such examination will demonstrate that the manner in which the intangibles were used by the taxpayer had no relationship whatsoever to the drilling of oil wells and the selling of oil products in California.

II.

**Support in the Record for the Finding of a Commercial Domicile in California Does Not Aid the Motion to Dismiss.**

Appellee recites at length the facts claimed to support the trial court finding that the commercial domicile of the taxpayer was in California (Motion, pp. 11-16).

Although the record shows that the taxpayer engaged in significant activities in California, although it can be argued that such activities were under the direction and control of the officers in the Los Angeles office, the existence of one principal office in California, or even the existence of one commercial domicile there, is not the crux of this appeal. Appellee places special emphasis on the California, activities. However, those activities related only to drilling for and production of oil and the sale of oil products. Drilling and exploration of underground oil reserves require substantial payrolls and substantial expenditures. The extent of these activities, however, no matter how great, does not negate the existence of other enterprises, nor does it support of itself an inference that all other activities are part thereof. The record here shows another separate business, which was carried on in New Jersey, far larger in terms of investment and revenue, although smaller in terms of personnel and bookkeeping.

Even if it be the law that a corporation can have only one commercial domicile no matter what the diversification of its business, the record reveals that the most significant business activities of appellant were carried on

in New Jersey and that New Jersey rather than California should be that domicile. We submit, however, that there can be as many commercial domiciles as there are separate businesses. No court has so held; none has held to the contrary, but such a proposition is the logical result of application of the reasons behind the rule.

## III.

## The Taxpayer Conducted an Active, Aggressive and Separate Investment Business in New Jersey.

Appellee puts the question well when on page 22 of the Motion it asserts:

> "Although it may be true, as asserted by appellant, that the activities of protecting and controlling investments may be the predominant activity of a corporation, it is necessary to examine all the facts in order to ascertain if that is true with respect to a particular corporation . . ."

The facts relating to the taxpayer's investment activity are set forth completely in the Statement as to Jurisdiction, at pages 8-12. That discussion shows a portfolio valued at more than $28,000,000; sales, purchases and loans of nearly $7,000,000 during the three years and income in excess of $2,700,000. Appellee contends the supervision and management of these changing investments did not constitute a separate business. Yet appellee refers to the fact that the New Jersey office kept its own records showing cash receipts and disbursements, "and a record of activities relating to the investments and financing of the company" (Motion, p. 14). Appellee further recognizes and concedes the dual nature of taxpayer's business. It (1) asserts that Mr. Kluth "made the important decisions with respect to the oil production operations of the tax-

payer" (Motion, p. 14), (2) recognizes that deposits in Los Angeles bank and payments therefrom arose from taxpayer's "oil operations", (3) makes specific reference to the following three items of evidence:

a. "Through economic conditions, it became apparent that we should acquire reserves in the ground for less by buying indirect reserves through securities than we could by going out and developing properties in direct costs" (Motion, p. 16, statement of Mr. Rowland, President of the taxpayer, as to why investment was made in securities).

b. "The business of the company is considered to be divided between (a) direct operations in the oil business and (b) all other business, including indirect oil operations through stock ownership" (Motion, p. 19, from the annual report of the taxpayer for the year 1939 [Pltf. Ex. 22]).

c. "George F. Getty, Inc., the surviving corporation, in the consolidation and merger hereinbefore mentioned, was not formed primarily as an investment medium, but has other large interests in the oil business and derives a major portion of its income from such interests. . . ." (Motion, p. 20, letter to Securities and Exchange Commission).

The efforts by appellee to belittle the investment activities of the taxpayer are contained in the Motion at pages 19 through 22. These efforts, rather than citing relevant facts from the record in the case, argue that certain inferences should be made. Appellee asks this Court to conclude that because income from investments declined from $1,138,561.11 in 1937 to $630,149.26 in 1939, therefore, the taxpayer was not actively engaged in the investment business. The true standard, however, for determining the extent of activities is to consider not only

the income, which was substantial, but also the acquisitions and sales and the management and supervision undertaken as the result of the investments. The record shows that sales and purchases of securities amounted to approximately $7,000,000, and that the investment portfolio received the active and vigorous supervision and management by the officers of the company in the New Jersey office. For example, it was from that office that the taxpayer and Pacific Western Oil Corporation, together developed and attempted to carry out in the East a plan for the acquisition of control in Tide Water Associated Oil Company, and for the control of Mission Corporation. The proration of salaries is not an accurate guide for determining the extent of interest of the corporations involved in this plan. Rather, the benefit which was sought is the more reasonable standard for determining whether the activities were bona fide and whether they were significant. The taxpayer's direct interest in Pacific Western Oil Corporation gave it an indirect interest in Tide Water Associated Oil Company amounting to more than 1,200,000 shares, in addition to the 404,854 shares owned outright by the taxpayer.

The portion of the Motion devoted to the taxpayer's investment business does not, when compared with the outline of the taxpayer's activities in connection with its investments as set forth in the Statement as to Jurisdiction, show a passive security holding. Rather it shows an aggressive active business of making the most of the securities, by income and capital appreciation, by purchases and sales, and by exercise of supervision and management.

As pointed out in the Statement as to Jurisdiction, the management of this security portfolio involved far more

than routine transactions relating to purchases, sales and receipt of income. The securities were used for the very purpose of exerting control of the management of companies in which the taxpayer had direct or indirect investment interests.

Nowhere is the record more emphatic than in the testimony of the man who was taxpayer's president during the period in question. He was asked and answered as follows [Rep. Tr. 701-702]:

> "Q. Now, turning to the oil business, how important relatively did you as president of George F. Getty, Inc. consider that investment?
>
> A. Let's first go back to my background. It is true that I have completed two years at U. C. L. A. studying petroleum geology. It is also true that I have completed several extension courses, finance and business administration.
>
> I know directly that I was hired not because of my oil background but rather because of my financial and business administration background. That was impressed upon me by Mr. Getty when I became associated with George F. Getty, Inc., accordingly, I must say that I agreed with that viewpoint because the investments of George F. Getty, Inc. were so heavy in favor of securities and the securities were a vehicle to an end of acquiring control of Tide Water, Skelly Oil and our other investments that I felt that was the most important phase of our business.
>
> Q. Did you consider the investment business as incidental to the actual oil operating business of George F. Getty, Inc. during those years?
>
> A. On the contrary, I felt that the oil business was incidental to the investment business, certainly the assets of, the dollars and cents involved in investments overshadowed that of the oil business."

## IV.

## There Was No Connection Between Taxpayer's Investment Business and the Production of Oil in California.

In the lower courts appellee contended that the intangibles were related to and a part of the business conducted by the taxpayer in California. Appellee concedes at pages 11 and 12 that the only business transacted by taxpayer in California related to the drilling for and production and sale of oil and gas in that State. The trial court made a finding [Finding XLV] that there was a connection between the California oil producing activities and the intangibles and their income. The review of such claimed connections as set forth in the Statement as to Jurisdiction (pp. 13-15), together with all the facts and inferences which appellee has mobilized, at pages 16-19 of its Motion, do not show any relationship between the intangibles and the oil and drilling activities.

A closer analysis of these alleged connections is highly revealing and most appropriate, for it is on this premise that the judgments of the lower courts were predicated and it is upon the alleged insufficiency that this appeal is based.

### A. Alleged Benefits From the Joint Operation of California Properties by the Taxpayer and Pacific Western Oil Corporation.

The taxpayer had investments in stock and notes of Pacific Western Oil Corporation, a controlled subsidiary, which averaged in excess of $4,500,000 during this period. Through this subsidiary, the taxpayer controlled Mission Corporation and Skelly Oil Company, both of which were very substantial corporations.

Included in the intangible income in question are the following items of income received by the taxpayer on stock and notes of Pacific Western Oil Corporation:

| | |
|---|---|
| Dividends | $ 808,482.60 |
| Interest | 275,865.55 |
| Capital Gains | 143,807.07 |
| | $1,228,155.22 |

During this period, the taxpayer shared offices and officers with this controlled subsidiary both in Los Angeles and in New Jersey. Furthermore, the two companies joined together in their California oil operations, with each bearing its relative share of the actual costs. The only benefit the taxpayer received from these arrangements was a reduction of expense.

Appellee seeks to have this Court infer that the stock and notes of Pacific Western Oil Corporation were acquired and held for the purpose of securing this expense-sharing arrangement. Appellee has not cited any facts in the record which point to such an inference. In this connection, it should be noted that the taxpayer's entire net income, before taxes, from its California oil operations during this period was only $642,512.88 and only a minor portion of such income could be attributed to the reduction of expenses secured by these joint operations.

When contrasted with the much larger amounts of income received directly from these intangible assets, as well as the direct control of other corporations secured by this holding, it would appear utterly unreasonable to conclude that these intangible investments had any connection with taxpayer's California oil operations, which were the only activities it conducted in that state.

**B. Alleged Benefits From Sales of Oil to Tide Water Associated Oil Company.**

The record discloses no sales of oil by the taxpayer to Tide Water Associated Oil Company in the years 1937 and 1938. In 1939, 296,279[2] barrels were sold by the taxpayer to Tide Water, as compared with taxpayer's total production of 1,959,113 barrels. Sales were made to thirteen different companies engaged in the refining and marketing of oil; two companies purchased amounts substantially in excess of those purchased by Tide Water. Each and all of the sales of oil by taxpayer to Tide Water were on an arm's length basis. Indeed, the relationship at that time between the management of Tide Water Associated Oil Company and the management of taxpayer was one of bitterness rather than friendship. The ownership by taxpayer of Tide Water stock and the resulting proxy battles certainly did not benefit the taxpayer in disposing of oil to Tide Water.

Included in the intangible income in question are the following items of income received by the taxpayer on stock of Tide Water Associated Oil Company:

| | |
|---|---|
| Dividends | $1,187,997.00 |
| Capital Gains | 211,865.60 |
| Total | $1,399,862.60 |

Taxpayer's investment in stock of Tidewater Associated Oil Company during this period approximated $2,500,000. Considering this large investment and the high returns thereon, here again it would be unreason-

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[2]The 3,000,000 barrels stated in the Motion at page 18 is obviously incorrect. [Pltf. Ex. 22, p. 210.]

able to infer that this stock was acquired or held for the purpose of providing an outlet for a minor portion of taxpayer's oil production in one year, or that it had any connection with taxpayer's California operations.

**C. The Alleged Benefits From Skelly Oil Company's Operations of Taxpayer's Mid-Continent Properties.**

Prior to 1938, The Mid-Continent properties (Texas, New Mexico, Kansas, Louisiana and Illinois) of the taxpayer were operated through its own offices in Carlsbad, New Mexico, and Fort Worth, Texas. In April of that year a written contract was executed under which Skelly Oil Company undertook to operate the producing properties of the taxpayer in the Mid-Continent area. Appellee has never claimed that this agreement was unfair. Moreover, the contract itself [Pltf. Ex. 21, pp. 82-84] specifically provided for renegotiation of the provisions in the event it proved unfair to either party. The agreement, by its very terms, was subject to cancellation by either party upon sixty days notice. At that time, taxpayer's capital investment in Mid-Continent properties amounted to approximately $600,000, while its indirect interest in stock of Skelly Oil Company amounted to many millions of dollars. It is absurd to even suggest that the indirect ownership in Skelly Oil Company was acquired or held for the purpose of effecting a contract for the routine operation of oil properties in the Mid-Continent area, which in turn had no connection with the California activities.

**D. The Alleged Use of Income From Intangibles to Cover Operating Expenses of California Oil Operations.**

Appellee, for the first time, asserts in its Motion that the intangibles and the income therefrom were related to California oil producing activities because of two transfers of funds from New York banks to California banks.

While overall control and authority over the California oil operations were vested in and exercised by the officers and directors in New Jersey, most of the activities in California were carried on by California officers and employees. Taxpayer had an office in Los Angeles and kept bank accounts in California over which the California officers exercised supervision.

The proceeds from the oil and gas sales were deposited in the California bank accounts and were used for those purposes. There is no evidence whatsoever that any of these funds were used for the purchase of securities.

In general, the oil operations were self-sustaining despite the fact that both production and sales declined somewhat during this period. The net income, before taxes, totalled $642,512.88 for the three years and provided ample funds for working capital purposes.

Appellee suggests (Motion, p. 19) that the investment securities were held and used as a means of raising working capital for the oil operations. It states that "funds were transferred from time to time from banks in New York to take care of the expenses of carrying on the oil operations of the company in California." The record does show that $150,000 were transferred from Eastern banks to the Los Angeles bank in 1938 and $100,000 were so transferred in 1939. However, the record does not indicate in any way that the funds were transferred or

used for the purpose of paying expenses. During each of these years the California oil operations were profitable, so there was no need for additional funds to cover expenses.

Plaintiff's Exhibit No. 23, a comparative balance sheet for the three years, shows that during 1938 and 1939 the net investment in California Lands, Leases and Mineral Rights increased from $203,707.85 to $467,909.56, or by $264,202.71 and that the net investment in California Plant and Equipment increased from $639,914.69 to $768,-496.63, or by $128,581.94. It seems obvious that the funds transferred to California were used for investment in capital assets and not to defray operating expenses.

Such transfers of relatively minor amounts of capital from one business division to another certainly does not justify any conclusion that "the intangibles had acquired a business situs or were a part of or correlated with a unitary enterprise" of taxpayer in California. (See *Marshall-Wells Co. v. Commissioner,* 220 Minn. 458, 20 N. W. 2d 92, 95.)

The above analysis of the occasions where business dealings by the oil producing division of the taxpayer coincided with the investments of the company do not show any connection between the intangibles and the oil producing properties and activities. Moreover, many items in the investment portfolio, such as German Government bonds, British pounds sterling, Richfield Oil Corporation stock, Getty Realty Corporation stock and Minnehoma Oil & Gas Company stock, are not claimed to have had any relation whatsoever with the oil production division. Yet the income therefrom has been included within the franchise tax imposed and upheld. The tests applied and announced by this Court require a substantial

connection between income from intangibles and the other activities. The ultimate fact of commercial domicile in California for these intangibles is not substantiated one iota by the record.

This Court in *First Bank Stock Corp. v. Minnesota,* referring to the stock ownership of banks serviced by the taxpayer, stated:

> ". . . But it is plain that the business which appellant carries on in Minnesota, or directs from his offices maintained there, is sufficiently identified with Minnesota to establish a 'commercial domicile' there, and to give a business situs there, for purposes of taxation, to intangibles which are used in the business or are incidental to it, and have thus 'become integral parts of some local business' ". (301 U. S. 234 at 237, 81 L. Ed. 1061 at 1063, 57 S. Ct. 677.)

The record in this case, to the contrary, shows clearly that the intangibles in question were not used in the California oil business, were not incidental to it, and had not become an integral part of the local business. Quite the opposite, these intangibles were an integral part of a business located and directed from the New Jersey office and had their business situs, for purposes of taxation, in New Jersey.

## V.

## The Equal Protection Clause of the Fourteenth Amendment Was Raised in the Courts Below.

Appellant has consistently argued that the application of the Bank and Franchise Tax Act to the income here involved violates the prohibition imposed upon States in the Equal Protection Clause of the Fourteenth Amendment. Paragraph XV of the Complaint stated "Said

determination, assessment and collection are also contrary to the Constitution of the United States of America and particularly Article Fourteenth of the amendments thereto. . . ."

Appellant's opening brief in the trial court stated at page 84:

> "The foregoing legal discussion in treating the invalidity of the attempted tax as unconstitutional raises questions under the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the Federal Constitution and Article I, Section 13, of the California Constitution. . . ."

In its Opening Brief in the District Court of Appeal appellant asserted the Due Process Clause of the Fourteenth Amendment and directly quoted from the principles announced and listed by this Court in *International Paper Co. v. Massachusetts,* 246 U. S. 135, 62 L. Ed. 624, 38 S. Ct. 292. Moreover, in its Petition for Hearing by the Supreme Court of the State of California (p. 20), appellant asserted the limitations of the Fourteenth Amendment.

## VI.
## Conclusion.

The underlying principles of state taxation have been discussed often. Taxation of intangibles or their income has been said to be proper in the jurisdiction where they have a tax situs. They have a tax situs where they are used. Taxation is justified, therefore, because the taxing state is providing protection and benefits. The facts in the instant case show beyond question that California was not where these intangibles were used, or were protected or benefited. The intangibles were the integral

part of a business conducted, planned and supervised from the executive offices of the company in New Jersey. Plenary consideration of this cause will demonstrate the constitutional invalidity of the tax imposed and will settle the questions shown to be of general importance to the multitude of corporations engaged in diversified business activities.

Respectfully submitted,

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